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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 39

JEAN McNEIL PEPPER

vs.

SCOTT LITTON

IN THE MATTER OF DIXIE SPLINT COAL COMPANY, BANKRUPT

BRIEF OF COUNSEL FOR PETITIONER

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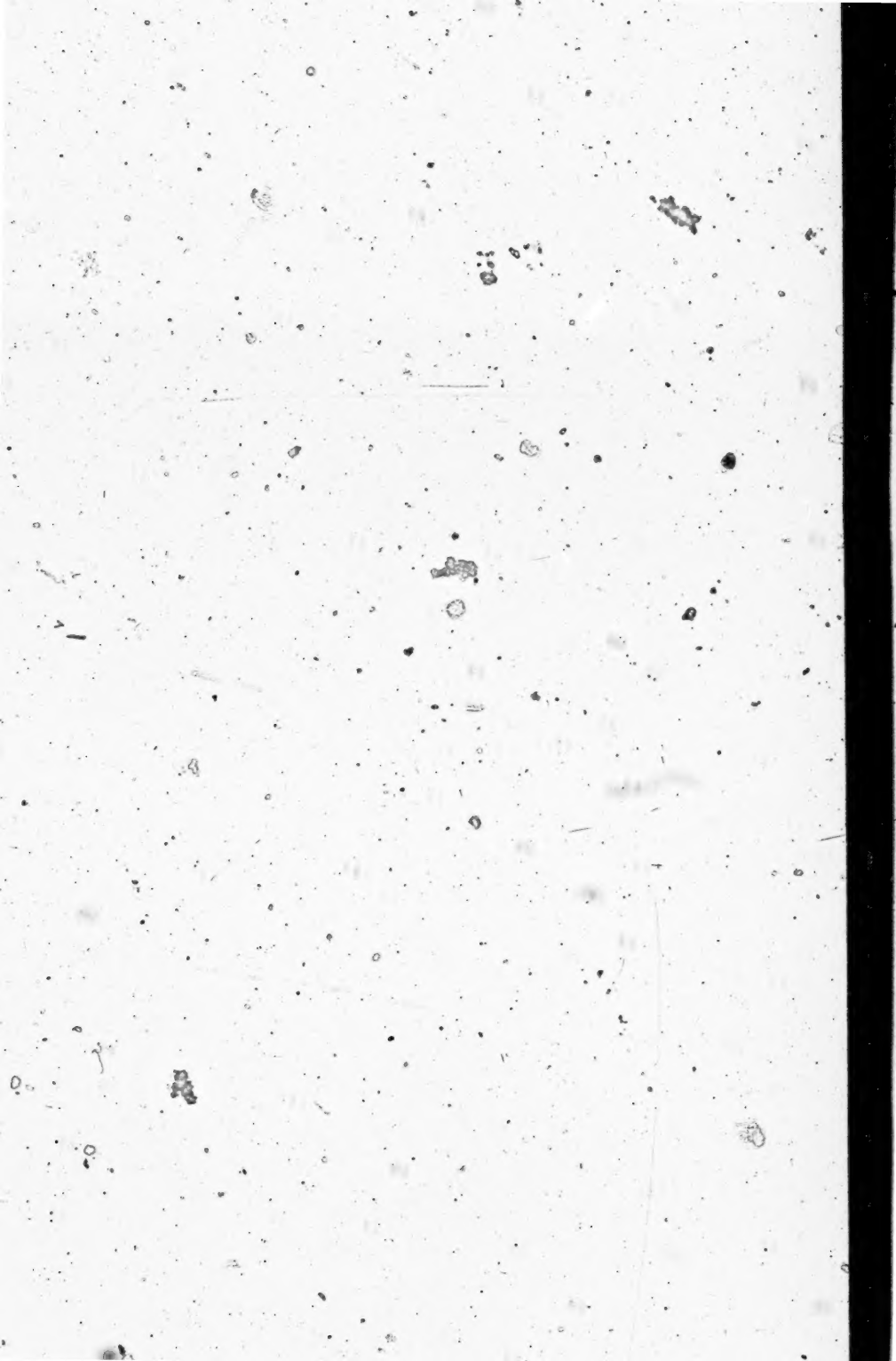

INDEX

SUBJECT INDEX

	Page
Opinions Below	1
Jurisdictional Statement	1
Statement of the Case	1
Assignment of Errors	12
Argument and Authorities	12
1. The Bankruptcy Court Has Exclusive Non-Delegable Jurisdiction of Question at Issue	12
2. The Decision of the State Court Is Of No Effect In The Bankruptcy Court	17
3. Pepper is Not Estopped To Assert The Invalidity of Litton's Judgment	22
4. This Court Should Refuse, Because of Litton's Fraudulent Conduct, to Interfere on His Behalf Or To Award Him Any Remedy	24
Conclusion	29

TABLE OF CASES CITED

Buffum v. *Peter Barceloux Co.*, 289 U. S. 227, 53 S. Ct. 539	29
Carter v. *Hobbs*, 92 F. 594, and note	17
Chandler v. *Thompson*, 120 F. 940.	19
Davis v. *Friedlander*, 104 U. S. 570	16

INDEX (Continued)

	Page
Eau Clair National Bank v. *Jackman*, 204 U. S. 522, 27 S. Ct. 391, 51 L. ed. 596	21
Ex Parte City Bank, 3 How. 292, 11 L. ed. 603	17
Gross v. *Irving Trust Co.*, 289 U. S. 342, 53 S. Ct. 605, 77 L. ed. 1243	15
Herman v. *Cullerton*, 7 Cir., 13 F. (2nd) 754	16
In re Continental Engine Co., 234 F. 58	19
In re L. & R. Wister & Co., 237 F. 739	22
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 739, 51 S. Ct. 270, 75 L. ed. 645	15
Linstroth Wagon Co. v. *Ballew*, 5 Cir., 149 F. 960	16
Mays v. *Fritton*, 20 Wall. 414	16
Miller v. *N. O. Acid & Fertilizer Co.*, 211 U. S. 496, 29 S. Ct. 176, 53 L. ed. 300	21
North Carolina R. Co. v. *Story*, 268 U. S. 288, 45 S. Ct. 531, 69 L. ed. 959	18
Norton v. *Boyd*, 3 How, 426	17
O'Brien v. *People*, 216 Ill. 354, 75 N. E. 108	23
Pepper v. *Dixie Splint Coal Co., et al*, 165 Va. 179, 181 S. E. 406	3, 25
School Trustees v. *Stocker*, 42 N. J. L. 116	23
Shelton v. *Sydnor*, 126 Va. 629	23
Shimer v. *Wister*, 244 U. S. 652, 37 S. Ct. 650, 61 L. ed. 1372	22
Springer v. *Shavender*, 118 N. C. 33, 23 S. C. 976	23
Smith v. *Litton*, 167 Va. 263, 188 S. E. 214	10, 14
Spencer v. *Duplan Silk Co.*, 191 U. S. 526	16
U. S. Fidelity & Guaranty Co. v. *Bray*, 225 U. S. 205, 32 S. Ct. 620, 56 L. ed. 1055	13, 14
United States v. *Wood*, 290 F. 109, affirmed 263 U. S. 680, 44 S. Ct. 134	13
Wallop's Admr. v. *Scarburgh*, 5 Gratt. 1, 15 R. C. L. 659	9
Winchester v. *Heiskell*, 119 U. S. 450	16

STATUTES CITED

	Page
Bankruptcy Act, Section 24c as amended June 22, 1938, 52 Stat. 854 (11 U. S. C., Section 47c)	1
Bankruptcy Act, Sec. 23(a), 11 U. S. C. 46(a)	16
Judicial Code, Section 240 (28 U. S. C., Sec. 347)	1
United States Code, Title 11, Section 11	24
Virginia Code, Sec. 6130A	3, 19, 26

TEXT BOOKS CITED

Freeman on Judgments (5th ed.) Vol. 1 at p. 640	23
Pomeroy's Equity Jurisprudence (3rd ed.), sec. 513	25
Remington on Bankruptcy (4th ed.) Sections 2170, 2182 and 2183	16
Remington on Bankruptcy (4th ed.) Section 2169	17

I.

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals for the Fourth Circuit which accompanied the judgment complained of appears in the Record at page 407, and is also officially reported as follows:

Litton v. *Pepper*, 100 F. (2d) 830.

The two opinions of the District Court of the United States for the Western District of Virginia in this case are not officially reported, but appear in the Record at pages 53 and 122, respectively.

II.

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is invoked under Section 24c of the Bankruptcy Act as amended June 22, 1938, 52 Stat. 854 (11 U. S. C., Sec. 47c), which vests this Court with jurisdiction to review judgments, decrees and orders of the Circuit Courts of Appeals in proceedings under the Bankruptcy Act.

The jurisdiction to review by certiorari is granted by Section 240 of the Judicial Code (28 U. S. C., Sec. 347).

III.

STATEMENT OF THE CASE

The question to be decided in this case is whether the claim of Scott Litton, the respondent, for $33,468.89, shall be allowed for payment from the estate of Dixie Splint Coal Company, Bankrupt.

If the claim is allowed as a judgment it will consume all the assets of the estate, to the exclusion of petitioner, and all other common creditors; and, if it is allowed as a common claim, it will diminish, by more than three-fourths, the dividend which petitioner will receive.

The District Court, after consideration of the merits of Litton's claim, wholly disallowed it either as a secured, or as a common claim on the grounds: that the purported judgment is void upon its face; and the alleged account, on which the judgment was based, is both fictitious and fraudulent (R. 122).

The District Court was reversed by the Circuit Court of Appeals; but not upon a consideration of the merits or validity of Litton's claim, but because, the latter Court held, the decision of a Virginia state court in a suit by the trustee against Litton should be given the effect of allowing the claim in bankruptcy regardless of its manifest invalidity and fraudulent character.

The litigation results from the efforts of Litton to prevent the payment of a just debt due Petitioner from Dixie Splint Coal Company, bankrupt.

The established facts reveal a deliberate and legalistically planned scheme on the part of Litton, not only to use the fiction of corporate entity to escape liability, but, through his complete control of his now bankrupt corporation, to gather to himself all its assets. Litton's domination of the corporation was so complete that its acts are his acts. In the course of his opinion the District Judge said:

> "I speak of Litton *and* Dixie Splint Coal Company because they are in reality the same." (R. at p. 61.)

In 1931 a suit was begun by A. P. Pepper against Dixie Splint Coal Company, in the Corporation Court of the City of Bristol, Virginia, for an accounting of rents and royalties due him for a lease of coal lands. A judg-

ment for $9000.00, with interest and costs, was rendered against the corporation on February 19, 1934 (R. 214). During the pendency of this suit Pepper died, and petitioner, Jean McNeil Pepper, his sole devisee, was substituted in his place.

The patently fraudulent devices employed by Litton to escape contractual liabilities are described in the decision of the Supreme Court of Appeals of Virginia in *Pepper* v. *Dixie Splint Coal Co., et al,* 165 Va. 179, 181 S. E. 406, which resulted from an appeal by Pepper, from the decision of the trial court, that Litton was not personally liable for the debts there in question.

On June 2, 1933, when the suit in the Bristol court was approaching judgment, Litton sent his subservient secretary-treasurer of his corporation to the Clerk's Office of the Circuit Court of Russell County, Virginia, to confess judgment in his (Litton's) favor for $33,468.89 (R. 181-184). The confession of judgment was attempted without the express authority required by the Virginia law (Va. Code Sec. 6130). This appears from the record of the purported judgment (R. 181-184). Upon this ground the Circuit Court of Russell County, Virginia, expressed the opinion that the judgment was void (R. 153). For the same reason the Referee in Bankruptcy held the judgment void (R. 109). This holding was expressly approved by the District Court (R. 120).

On June 2, 1933, the day the void judgment was docketed, Litton caused execution to issue thereon; but no levy was made. Hence, no lien was acquired on the corporation's personal property.

On February 19, 1934, when petitioner obtained judgment against Dixie Splint Coal Company in the Bristol court, Litton falsely represented that his corporation intended to appeal from its judgment to the Virginia Supreme Court of Appeals. On this representation a stay of execution for ninety days, from February 19, 1934, was ordered on petitioner's judgment (R. 215).

On March 19, 1934, during the ninety-day stay period, Litton sued out a second execution on his purported judgment; and caused his execution on that day to be levied on all the tangible property of his company. But no sale was then advertised under his execution levy (R. 184; 254).

On May 31, 1934, after the expiration of the ninety-day stay period, petitioner sued out execution on her judgment against Dixie Splint Coal Company. It was levied on all the tangible property of the company on June 2, 1934 (R. 237, 238).

On the last named date, a deputy sheriff, obviously cooperating with Litton, advertised a sale to be made on June 14, 1934, to satisfy Litton's execution, which had been levied two and one half months previously. (R. 216, 217; 254, 255).

On June 13, 1934, the day preceding the advertised execution sale, petitioner filed her bill in the Circuit Court of Russell County, Virginia, alleging that the Litton judgment was void, and that the corporation did not owe Litton any sum (R. 210). Among other things, the bill prayed that the sale be enjoined; but, on account of the absence of the judge, the prayer for injunction was not acted upon.

On June 14, 1934, a purported sale was held, and Litton became the purchaser of all the tangible personal property of his corporation at the price of $3200.00 (R. at page 238).

Two days after the purported execution sale Litton caused the board of directors of his one-man corporation to adopt a resolution directing the voluntary bankruptcy of his Dixie Splint Coal Company, the bankrupt (R. 1). However, the petition was not filed until September 4, 1934, or seventy-nine or eighty days after the bankruptcy resolution (R. 1). During the eighty days delay Litton's lien under the levy he had made became more than four

months old; but petitioner's lien, under her levy of June 2, 1934, was less than four months old, and, therefore, not a lien in bankruptcy.

On June 16, 1934, Litton's company executed to Clinchfield Coal Corporation a release of the coal lease for the only coal property then being mined by it (R. 101). This was more than two months before the company filed its petition in bankruptcy; and on the same day the company by resolution determined to file its bankruptcy petition.

On June 21, 1934, Litton procured the incorporation of Dixie Beaver Coal Corporation, to which he sold all the tangible property he had purchased for $3,200.00 under his own void execution sale, and received therefor the fully paid capital stock of his new company in the par amount of $20,135.36 (R. 106).

On June 22, 1934, Litton's new corporation, Dixie Beaver Coal Corporation, obtained from Clinchfield Coal Corporation a lease covering the same coal lands which Dixie Splint Coal Company had released six days previously (R. 105, 106).

Commencing the last of March or the first of April, 1934, Litton, and, at his instance, Smith, his subservient secretary-treasurer, began making heavy withdrawals of cash from Dixie Splint Coal Company through their respective "personal" ledger accounts. From March 31 to May 31 Litton withdrew a total of $5,022.96. From April 30 to July Smith withdrew $4,833.32 (R. 79; 83).

These "personal" ledger accounts were found by the District Court to be both fictitious and fraudulent (R. at p. 127). Litton and Smith were regularly compensated for their services on the payroll, Litton receiving $500.00 per month (R. 91) and Smith, $250.00 per month (R. 87).

Thus the stage was set for the voluntary bankruptcy of the now bankrupt Dixie Splint Coal Company.

During the last ninety days the Dixie Splint Coal

Company was in business Litton and Smith together fraudulently withdrew practically all the cash of the bankrupt company, in a total sum sufficient to have paid the debt due petitioner.

By June 22, 1934, Litton's new corporation had all the personal mining machinery and property of the bankrupt company, and was operating the same leasehold estate which had belonged to, and had been operated by, the bankrupt Dixie Splint Coal Corporation only eight days before.

On June 15, 1934, the next day after the purported execution sale, the sheriff of Russell County with $3,200.00, the proceeds of the sale, in hand commenced interpleader proceedings. Petitioner, Litton, and Clinchfield Coal Corporation, which claimed a prior lien in the amount of $2,153.00 on the property sold, were made parties defendant (R. 237).

Litton answered, admitting the amount and priority of the claim of Clinchfield Coal Corporation, and that said claimant "is entitled to have its said lien paid and satisfied out of the proceeds of said sale" (R. 243, 244).

Pepper answered, refusing to assert any claim to the proceeds of sale but expressly saving her objections to the validity of the Litton judgment, saying:

> "Without prejudice to her rights and claims asserted in the Chancery cause of Jean McNeil Pepper, Executrix, etc. against Scott Litton, et als, now pending in the Circuit Court of Russell County, Virginia, the general subject of which is to set aside and have declared void the judgment under which the sale was made, from which M. C. Chafin, Deputy Sheriff for N. F. Castle derived the fund here in question, answers that she admits the priority of the lien asserted by Clinchfield Coal Corporation in the sum of Two thousand One hundred and Fifty three dollars ($2,153)." (R. 241).

This answer made by petitioner is the ground of the

"estoppel" subsequently attempted to be invoked by Litton against petitioner.

On September 4, 1934, eighty days after the resolution directing voluntary bankruptcy of Dixie Splint Coal Company, and two and one-half months after the company had ceased to do business, the said Company filed its voluntary petition in bankruptcy (R. 1). The first meeting of creditors was held on September 26, 1934; but petitioner was neither present, nor represented, because Litton had omitted her address from the bankruptcy schedules prepared and filed by him (R. 24).

At said meeting, P. H. Smith, secretary-treasurer of the bankrupt corporation, was elected trustee. I. M. Quillen, personal attorney for Litton and of counsel for the bankrupt, was selected as attorney for the trustee (R. 3, 4).

At this same meeting Litton filed a proof of claim asserting a first lien upon all the assets of the bankrupt by virtue of the supposed lien of a writ of *fieri facias* issued from his alleged confessed judgment, more than four months prior to the bankruptcy (R. 4, 5). The assets consisted of funds due to the bankrupt, which were to come into the trustee's hands for administration by the bankruptcy court. A fund of approximately $6,000.00 constitutes the present estate (R. 117).

On October 6, 1934, Pepper, in aid of her pending chancery suit, filed in the Circuit Court of Russell County a motion to quash the Litton judgment. Litton opposed the motion on the ground of the bankruptcy of Dixie Splint Coal Company, the judgment-defendant; and, contended that such an attack on his alleged judgment could not be maintained "except in the name of the Trustee" (R. 230, 231). On October 15, 1934, Pepper filed a petition in the bankruptcy matter, praying that the trustee be directed to contest the validity of the Litton judgment (R. 271). On October 17, 1934, the referee entered an

order granting the relief prayed for by petitioner (R. 270).

Mr. Quillen, who was then counsel for both the trustee and Litton, immediately excepted to this action of the referee on the ground "that Mrs. Pepper is not entitled to the relief asked in her petition because she has filed no proof of claim in bankruptcy", and offered to resign as counsel for the trustee (R. 275).

The referee reheard the matter on November 8, 1934, on which date Pepper filed her general proof of claim (R. 19). At this hearing Litton's counsel again opposed an attack on the confessed judgment, this time on the stated ground "that Jean McNeil Pepper is estopped to contest the validity of the judgment of Scott Litton by reason of her acts and conduct in relation thereto" (R. 22).

Petitioner's answer in the interpleader suit, hereinbefore quoted, was placed in evidence before the Referee; and it is the basis of the estoppel pleaded in the bankruptcy court (R. 23).

New counsel had been selected for the trustee, and had filed a petition asking for permission to institute a new and independent suit in the Circuit Court of Russell County for the purpose of testing the validity of the confessed judgment (R. 25).

On December 18, 1934, after hearing argument of counsel, the referee entered an order directing the trustee's counsel to institute proceedings in the Circuit Court of Russell County "for the purpose of testing the validity of the judgment" (R. 188-190).

By this order the Referee necessarily overruled the contention of Litton that either Pepper, or the trustee, were estopped to question the validity of the confessed judgment. Litton sought no review of the order.

Prior to the date of the commencement of proceedings by the trustee, Litton purchased, or attempted to purchase,

and to have withdrawn every unsecured claim against the bankrupt except the claim of Pepper (R. 303).

On January 10, 1935, the trustee filed in the Circuit Court of Russell County a motion to set aside the confessed judgment on the ground that same was void upon its face. A copy of the motion was served upon Litton, the judgment-plaintiff (R. 178). The attack thus made was not collateral, but direct, and one that could, therefore, be maintained only by a party to the judgment (See *Wallop's Admr.* v. *Scarburgh*, 5 Gratt. 1; 15 R. C. L. 659).

However, the state court erroneously decided that the right of the trustee to attack the validity of the Litton judgment was a right acquired under section 70e of the Bankruptcy Act (R. at 154). This section invests the trustee with the right to avoid any *transfer of property* by the bankrupt which any *creditor* might have avoided. The court then proceeded, over the objection of the trustee, to undertake to determine who were the creditors of the bankrupt estate, and who would benefit by the success of the trustee's suit. The court held, contrary to the actual facts, that Pepper was the only creditor of the bankrupt estate, and that the trustee was attempting to exercise her rights (R. at 156, 157). At this time no unsecured claims had been allowed against the estate, and time yet remained in which to file proofs (R. 321-327). Subsequently, on April 23, 1935, several unsecured claims were allowed (R. 32-34). Pepper's unsecured claim had been excepted to and was not allowed until three years later, on February 4, 1938 (R. 116).

The State court further held that Pepper's answer in the interpleader suit had "treated" the execution sale as a valid sale, and that such treatment amounted to the "recognition" of the validity of the Litton judgment.

From these manifestly erroneous findings upon extraneous matters beyond the court's jurisdiction, and upon these false premises, the court proceeded to the conclusion that the trustee in bankruptcy was "estopped", at that

time, to have the Litton judgment decreed invalid, although the court found the judgment to be utterly void upon its face (R. 153).

The trustee appealed to the Supreme Court of Appeals of Virginia (R. 143). That court affirmed the lower court's holdings. *Smith* v. *Litton*, 167 Va. 263, 188 S. E. 214.

On December 18, 1934, Pepper excepted to the allowance of Litton's claim in bankruptcy, both on the ground that the validity of the judgment was in question, and that the amount claimed was never due and owing from the bankrupt to Litton (R. 6).

On February 22, 1937, the bankruptcy matter came on again to be considered by the referee. The referee, without entering a specific order to that effect, dismissed the exceptions to Litton's claims and allowed same as a secured claim.

On April 22, 1937, the District Court, on review petitioned for by Pepper, reversed the referee and remanded the proceedings with directions to pass upon the objections to Litton's claim filed by Pepper (R. 52).

In a written opinion the District Court reviewed the history of the litigation, and pointed out the frauds Litton was attempting to perpetrate upon Pepper and upon the bankruptcy court. The court specifically held that the duty to administer the estate of the bankrupt, in the custody of the bankruptcy court, was in such court, and was a right and duty that could neither be lost nor delegated (R. 53-66).

On February 4, 1938, after hearing evidence, the referee entered an order holding:

(a). That the Litton judgment was void;

(b). That the Litton claim was good as a common or unsecured claim;

(c). That Pepper was estopped to rely upon her ob-

jections to Litton's claim, and that same would be allowed as a secured claim;

(d). That Pepper was barred by laches and estoppel from seeking an appraisal of the bankrupt's property purportedly sold to Litton at the execution sale under the void judgment;

(e). That Litton's exceptions to the allowance of Pepper's claim should be overruled and her claim allowed as a general or unsecured claim (R. 107-116).

Litton did not seek review of the referee's holdings that were adverse to him, that is, that the confessed judgment was void, and that his objections to Pepper's claim be overruled. These holdings thus became final.

Pepper, however, sought review of the holdings that were adverse to her (R. 117-120). On June 23, 1938, the District Court entered an order sustaining her contentions and disallowing Litton's claim either as a secured claim or a general claim (R. 120, 121).

In a written opinion the court again reviewed Litton's fraudulent efforts to defeat an honest debt and to take to himself all the assets of the bankrupt. His claim was disallowed, the opinion shows, because the purported judgment on which it was based was utterly void, and because the alleged account on which the judgment had been confessed was fictitious and fraudulent (R. 122-132).

Litton appealed to the Circuit Court of Appeals for the Fourth Circuit from the order of the District Court disallowing his claim (R. 403).

On January 10, 1939, the Circuit Court of Appeals reversed the order of the District Court and remanded the cause "with instructions to give effect to the decision of the State Court, and for further proceedings in accordance with the opinion of the Court filed herein" (R. 413).

On June 5, 1939, this Court on the petition of Jean McNeil Pepper granted certiorari. (R. 460).

IV.

ASSIGNMENT OF ERRORS

Petitioner relies upon the errors specified in the Petition for Writ of Certiorari at pages 10 to 13, that the Circuit Court of Appeals for the Fourth Circuit erred in reversing the decree of the District Court of the United States for the Western District of Virginia, erroneously deciding, in effect:

First, that the bankruptcy court did not have exclusive, non-delegable jurisdiction to adjudge whether the claim of Scott Litton should be allowed, or disallowed, for payment from the bankrupt estate in custody of the bankruptcy court, ~~and disallowing Litton's claim and in thereby permitting the consummation of an obviously fraudulent scheme by use of the processes of the bankruptcy court.~~

Second, that a court of bankruptcy will permit its processes to be used in consummation of an obviously fraudulent scheme; or that it will lend its aid to one who is proved guilty of conduct in violations of fundamental conceptions of equity jurisprudence.

V.

ARGUMENT AND AUTHORITIES

1.

THE BANKRUPTCY COURT HAS EXCLUSIVE, NON-DELEGABLE JURISDICTION OF QUESTION AT ISSUE.

The question is whether the Circuit Court of Appeals erred in reversing the decree of the District Court, which adjudged:

"That the claim of Scott Litton in the sum of $33,468.89 is not a valid debt owing by the bankrupt either as a secured claim based on his purported judgment or as a general or unsecured debt and the same is hereby disallowed." (R. 121).

If Litton's claim is disallowed, then the trustee is directed by the District Court to

"take appropriate and necessary steps to recover for the benefit of the bankrupt estate such property or the value of such property as was sold to Scott Litton on June 14, 1934, under an execution issued on said Litton's void judgment against the bankrupt." (R. 121).

The decision of the District Court is clearly an adjudication upon a "proceeding in bankruptcy" over which the courts of bankruptcy exercise jurisdiction exclusive of that of all other courts.

U. S. Fidelity & Guaranty Co. v. *Bray*, 225 U. S. 205, 32 S. Ct. 620, 56 L. ed. 1055.

United States v. *Wood*, 290 F. 109, affirmed 263 U. S. 680, 44 S. Ct. 134.

In *U. S. F. & G. Co.* v. *Bray*, *supra*, this Court, in construing section 2 (2) of the Bankruptcy Act (11 U. S. C., sec. 11), held:

"We think it is a necessary conclusion from these and other provisions of the Act that the jurisdiction of the bankruptcy courts in all 'proceedings in bankrupcy' is intended to be *exclusive of all other courts, and that such proceedings include, among others, all matters of administration, such as the allowance, rejection, and reconsideration of claims,* the reduction of the estates to money, and its distribution, *the determination of the preferences and priorities to be accorded to claim presented for allowance and payment* in regular course * * *."

In this case the Circuit Court of Appeals held that neither it nor the District Court had jurisdiction to pass upon the merits of Litton's claim because of the "binding effect" of a decision of the Circuit Court of Russell County, affirmed by the Supreme Court of Appeals of Virginia, in a suit by the trustee against Litton (*Smith, Trustee* v. *Litton*, 167 Va. 263, 188 S. E. 214). The Circuit Court of Appeals did not hold that Litton's claim should be allowed on its merits, either as a secured or an unsecured claim. On the other hand, that Court left undisturbed, and tacitly, at least, approved the finding of the District Court that the claim is invalid and fraudulent (R. 408-412). However, the effect of the decision is to allow the claim as a secured claim.

The expressed reason for the decision of the Circuit Court of Appeals is that the holding of this Court in *U. S. F. & G. Co.* v. *Bray, supra*, and other cases relied on by petitioner, are not applicable because they

> "* * * do not envision the situation which results when the trustee in bankruptcy has sought and obtained the decision of a *competent* state tribunal upon the *validity* of a disputed *claim* or judgment *against the* (*bankrupt*) *estate*". (Italics supplied).

Herein, we submit, is the error in the court's decision. *No state tribunal, nor any court other than the court of bankruptcy, is competent to pass upon the validity and allowability of a claim presented for payment in the bankruptcy court.*

That is the exact holding of this court in the *Bray case, supra.* It is well established that the jurisdiction to allow, disallow and reconsider claims presented in the bankruptcy court cannot in any way be waived, abandoned, delegated or surrendered, by the bankruptcy court, or by action of its officers.

U. S. F. & G. Co. v. *Bray, supra.*

Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 739, 51 S. Ct. 270, 75 L. ed. 645.

Gross v. *Irving Trust Co.*, 289 U. S. 342, 53 S. Ct. 605, 77 L. ed. 1243.

In the *Bray* case one of the claimants in bankruptcy had been expressly authorized by the referee to institute litigation in another court. In passing upon the effect of this authorization, this Court held:

> "Of the fact that the suit was begun in the Circuit Court with the express leave of the Court of bankruptcy it suffices to say that the latter was not at liberty to surrender its exclusive control over matters of administration, or to confide them to another tribunal."

In *Isaacs* v. *Hobbs Tie & Timber Co., supra,* the trustee invoked the jurisdiction of another court as to the disposition of the bankrupt's property, and the validity of a claim against it. It was contended that the trustee had thus estopped himself to later set up the exclusive jurisdiction of the bankruptcy court. This court held:

> "There is no merit in this contention. The jurisdiction in bankruptcy is made exclusive in the interest of the due administration of the estate and the preservation of the rights of both secured and unsecured creditors. This fact places it beyond the power of the Court's officers to oust it by surrender of property which has come into its possession (citing cases). Indeed, a court of bankruptcy itself is powerless to surrender its control of the administration of the estate."

It follows, therefore, that the decision of the Circuit Court of Russell County, Virginia, can not be accorded the effect of ousting the bankruptcy court of its jurisdiction to pass upon the allowance of Litton's claim, even though the referee authorized the suit to be brought in the state court.

It is obvious that the Circuit Court of Appeals was led to its erroneous decision by confusing the question here involved, which, as has been hereinbefore pointed out, is distinctly a "proceeding in bankruptcy" over which the courts of bankruptcy exercise exclusive jurisdiction, with "controversies" between trustees and "adverse claimants" over which the courts of bankruptcy and other courts exercise concurrent jurisdiction.

In holding that the state court had "jurisdiction to hear and determine the matter brought before it by the independent suit of the trustee", and "that the binding effect of the decision of the court is equally well established", the court cited the following authorities:

> *Mays* v. *Fritton*, 20 Wall. 414;
> *Spencer* v. *Duplan Silk Co.*, 191 U. S. 526;
> *Winchester* v. *Heiskell*, 119 U. S. 450;
> *Davis* v. *Friedlander*, 104 U. S. 570;
> *Linstroth Wagon Co.* v. *Ballew*, 5 Cir., 149 F. 960;
> *Herman* v. *Cullerton*, 7 Cir., 13 F. (2d) 754; and
> Sections 2170, 2182 and 2183 of *Remington on Bankruptcy.*

Examination shows that every one of the cases cited deals with a contest over the title to a fund, or property, in the custody of a state court, in which the trustee intervened to assert the title of the bankrupt. In other words, the cases are

> "controversies at law and in equity, as distinguished from proceedings in bankruptcy, between trustees as such and adverse claimants concerning the property acquired or claimed by the trustees * * *". *Bankruptcy Act*, sec. 23(a), 11 U. S. C., 46(a).

The sections of *Remington* cited simply refer to other situations, such as suits to recover property fraudulently

and preferentially conveyed by the bankrupt, in which the bankruptcy courts and other courts are granted concurrent jurisdiction by the Bankruptcy Act.

Clearly, the question before this Court is not a controversy between the trustee and an adverse claimant. It is simply the question of the allowability of a claim in bankruptcy. One claiming to be a lienholder as to property or funds in the custody of the bankruptcy court, as Litton is doing here, is not an "adverse claimant", and the bankruptcy court has exclusive jurisdiction to pass upon his claim.

Ex Parte City Bank, 3 How. 292, 11 L. ed. 603.
Norton v. *Boyd*, 3 How. 426, 11 L. ed. 664.
Carter v. *Hobbs*, 92 F. 594, and note.
Remington on Bankruptcy (4th ed.), sec. 2169.

It is equally clear that the proceeding in the state court was not a controversy between the trustee and an adverse claimant concerning property acquired or claimed by the trustee. It was simply a motion by the trustee, *in exercise of the rights of the bankrupt*, to set aside a purported judgment against the bankrupt on the sole ground that it was void upon its face. No property was sought to be recovered or retained by the trustee. The only judgment sought was a ruling upon the validity of the judgment upon its face. A lien claim had previously been filed by Litton in the bankruptcy matter, based upon the purported judgment, seeking allowance and payment from funds in the hands of the trustee.

2.

THE DECISION OF THE STATE COURT IS OF NO EFFECT IN THE BANKRUPTCY COURT.

The doctrine of res judicata, on which the Circuit Court of Appeals summarily disposed of the case, can in no

event be applicable unless the issue in the state court is shown to be identical with the issue presently before the bankruptcy court.

> "It is well settled that the principle of res judicata is only applicable to the point adjudged and not to points only collaterally under consideration, or incidently under cognizance, or only to be inferred by arguing from the decree." *North Carolina R. Co.* v. *Story*, 268 U. S. 288, 45 S. Ct. 531, 69 L. ed. 959.

The state court did not attempt to pass upon the validity of Litton's claim in bankruptcy. The Judge of the Circuit Court of Russell County in the course of his written opinion said:

> "This court does not undertake to pass upon the validity of any claim made or to be made against the bankrupt, nor to the disposition to be made of the bankrupt estate." (R. 155.)

By its decision in this case, the Circuit Court of Appeals has added to the actual holding of the state court and accorded to it an effect which that court did not intend, but expressly disavowed.

It is also clear that the referee did not intend to submit to the state court the question of the allowability of Litton's claim in bankruptcy. Nor, did the referee intend to submit to the state court for decision the question of whether Pepper was estopped, in the bankruptcy court, from challenging the validity of Litton's claim. Ten days before the referee decided to authorize a suit by the trustee in the state court "for the purpose of testing the validity of the (Litton) judgment", Litton's counsel contended before the referee that Pepper was estopped from challenging the lien of Litton's judgment "in any sort of proceeding". The contention was:

> "Counsel for Scott Litton * * * have already heretofore taken the position that Scott Litton's lien is a

valid one and that on account of certain waivers of rights and estoppel, *of which evidence has been presented to the Referee,* Litton's lien can not be successfully challenged in any sort of proceeding and that, therefore, in the exercise of the Referee's discretion the Referee should declare Scott Litton's lien valid and allow it as a preferred claim." (R. 27-28.)

This contention was considered, and was overruled by the Referee's order of December 18, 1934 (R. 188-190). At this time not only had the trustee's counsel questioned the allowance of Litton's claim on the ground that the judgment on which it was based was void. Pepper had filed formal exceptions to the allowance of the claim not only on this ground, but also that "the same does not constitute a common claim, since the amount claimed under said judgment was never due or owing to the said Scott Litton" (R. 6; 188).

Thus, before the referee could allow Litton's claim, it was necessary to decide, first, whether the purported judgment was valid; and, second, whether the claim on which the judgment was based was fraudulent in its entirety.

A decision that the judgment was either void or valid on its face would not determine the allowability of the claim. If it were found void, then the claim would have to be passed upon as a common claim. If the judgment were found valid on its face, it would yet be subject to attack on the ground that it was voidable because of fraud or collusion.

In re Continental Engine Co., 234 F. 58.

Chandler v. *Thompson*, 120 F. 940.

The single question presented to the state court for decision was whether the Litton judgment was *void on its face* (R. 178-181). This question involved the construction of a Virginia statute (Code of Va., sec. 6130(a), and

was one of first impression in the state. Hence, resort was had to a state court. The opinion of the Judge of the trial state court shows that this was the single question presented by the trustee's motion.

> "This is a proceeding to set aside and vacate a judgment confessed in the Clerk's Office of this court, by P. H. Smith, Secretary-Treasurer of Dixie Splint Coal Company, Inc., in favor of Scott Litton, a director and the President of said Corporation, on the 2nd day of June, 1933, for the sum of $33,468.89, for the alleged reason that said judgment was void and for the quashing of executions issued thereon.
>
> No question is made as to the validity or bona fides of defendant's claim, upon which the judgment was attempted to be confessed, nor as to the status of said corporation as to solvency or insolvency at the time of the alleged confession of judgment, nor as to the right of said Scott Litton to obtain a lien in his favor as against the other creditors of said corporation, *but the grounds relied upon to sustain the contention that said judgment is void in that it was not confessed under authority nor in the manner required by law.*" (R. 149).

But, as the opinions of the state courts show, they declined to adjudicate whether the judgment was void or valid. Thus, insofar as the bankruptcy court was concerned, the proceedings in the state courts were futile.

The actual holding of the state court, that is, that the trustee and Pepper were estopped to challenge the validity of the Litton judgment in the state court, can be given no effect in the bankruptcy court for four separate and distinct reasons:

(a). The state court was not legally competent to adjudge that anyone is estopped to contest the allowability of a claim in the bankruptcy matter. Otherwise it would be possible to oust the bankruptcy court of its

exclusive jurisdiction over the administration of the bankruptcy estate in its custody.

(b). The bankruptcy court had previously decided, upon the same evidence that was later before the state court, that neither Pepper nor the trustee were estopped to challenge the Litton claim *in the bankruptcy court.*

(c). The state court did not attempt to render a judgment having the effect of allowing a claim in the bankruptcy matter; but, conscious of the limitations upon its power in that respect, expressly disavowed such a purpose.

(d). The whole decision of the state court is not merely erroneous; it is invalid because the court exceeded its jurisdiction. As a basis for its holding the state court first attempted to adjudicate that Pepper was the only common creditor in the bankruptcy matter. This was contrary to the actual facts. Pepper's claim was not even allowed in the bankruptcy matter until three years after the suit in the state court (R. 107, 116). At the date of the state court's decision, time yet remained in which claims could be filed (R. 327). Several claims that had been filed as preferred claims were subsequently allowed as common claims (R. 32-34). The court then proceeded to hold that Pepper would be the only person to be benefited by the success of the trustee's suit; that she would be estopped to attack the Litton judgment; and that, therefore, the estoppel would be applied against the trustee.

The state court thus exceeded its jurisdiction.

Eau Clair Nat'l Bank v. *Jackman*, 204 U. S. 522, 27 S. Ct. 391, 51 L. ed. 596.

Miller v. *N. O. Acid & Fertilizer Co.*, 211 U. S. 496, 29 S. Ct. 176, 53 L. ed. 300.

These cases deal with suits to recover preferential transfers over which state courts have jurisdiction concurrent with the federal district courts. The cases hold that the legal rights of a trustee, suing in a state court, are not varied in the slightest degree by the probable manner in which the assets of the bankrupt estate may be administered if the trustee's suit is successful. The ascertainment of who are or may be the creditors in bankruptcy was held to be a question "depending on independent considerations exclusively cognizable in the bankruptcy court."

3.

PEPPER IS NOT ESTOPPED TO ASSERT THE INVALIDITY OF LITTON'S JUDGMENT.

As hereinbefore pointed out, prior to the commencement of the proceeding in the state court, the referee had held that Pepper was not estopped to assert the invalidity of the Litton judgment in the bankruptcy court. Even if that question can now be again considered in the bankruptcy court, it is clear that the doctrine of estoppel has no application to the circumstances of this case.

The purported judgment under which Litton claims is no judgment at all. It is void upon its face, and there is now no serious contention in the case either that the judgment is valid or that it is merely voidable. Such a contention could not be considered. The referee affirmatively held that the judgment was void upon its face (R. 109). No review of this holding was sought by Litton. It has thus become final.

In re L. & R. Wister & Co., 237 F. 739, Certiorari denied *Shimer* v. *Wister*, 244 U. S. 652, 37 S. Ct. 650, 61 L. ed. 1372.

A judgment void upon its face, as distinguished from a voidable judgment, is no judgment at all but a mere

nullity. It may be assailed in any court by anyone at any time that a claim is made or a right asserted under it. This principle is too well known and too well established to require citation of authority for its support.

The right to object to a lack of jurisdiction, or legal power, in the official or tribunal rendering a judgment cannot be lost in any manner.

> "Neither the consent of the parties nor waiver, nor acquiescence can confer it (jurisdiction), nor can the right to object for a want of it be lost by acquiescence, neglect, estoppel or any other manner."
>
> *Shelton* v. *Sydnor*, 126 Va. 629.
> *School Trustees* v. *Stocker*, 42 N. J. L. 116.
> *Springer* v. *Shavender*, 118 N. C. 33, 23 S. C. 976.
> *O'Brien* v. *People*, 216 Ill. 354, 75 N. E. 108.

The only circumstance in which one may be estopped to assert that a judgment void upon its face *is* void, is when the person attacking the judgment is the one at whose instance the void judgment was rendered.

> "Even where the circumstances are such as might otherwise afford sufficient grounds for successful attack collaterally upon a judgment or decree, the conduct of a party may be such as to estop him from availing himself of those grounds. The general rule has been laid down and is supported by numerous decisions, *that a party at whose instance a judgment was rendered* is not entitled in a collateral proceeding to contend that the judgment is invalid. *The reason or principle on which these decisions rest is not technically the doctrine of estoppel in the ordinary signification and acceptance of the term*, but the principle that a person, *having invoked the jurisdiction of a court, and submitted himself thereto*, cannot be heard thereafter in a collateral proceeding, to question the jurisdiction *so invoked.* * * *." (Italics supplied). (*Freeman on Judgments* (5th Ed.) Vol. 1, at p. 640).

Obviously, this principle has no application to the present case. Pepper had nothing whatever to do with the proceeding in which the alleged judgment was confessed. She had neither notice nor knowledge of it. Upon every occasion she has *expressly denied* the authority of the Clerk of the Circuit Court of Russell County to enter the alleged judgment.

For this reason alone, it is clear that Pepper is not "estopped" to assert that the Litton judgment is utterly void.

4.

THIS COURT SHOULD REFUSE, BECAUSE OF LITTON'S FRAUDULENT CONDUCT, TO INTERFERE ON HIS BEHALF OR TO AWARD HIM ANY REMEDY.

This court as a court of bankruptcy is likewise a court of equity. 11 U. S. C., sec. 11.

The decision of the Circuit Court of Appeals approves or condones the obviously fraudulent scheme of Litton to prevent a bona fide creditor from collecting a just debt. It condones the use of the processes of the bankruptcy court to consummate the scheme. It awards to the wrongdoer all the assets of the bankrupt estate upon an utterly void judgment attempted to be confessed on a fraudulent and fictitious account. It deprives petitioner, a bona fide creditor, of any satisfaction from the bankrupt estate.

This shockingly inequitable result is reached by the application, or rather misapplication, of the equitable doctrine of estoppel which is relied on by Litton.

We have hereinbefore demonstrated that as a matter of law and as a matter of fact Litton is entitled to no part of the bankrupt estate, and that petitioner is entitled to participate in the distribution of the estate.

We submit that it is in violation of all principles of equity jurisprudence to permit the unjust result accomplished by the decision of the Circuit Court of Appeals in this case.

A court of equity will not permit the use of its facilities to a wrong-doer. This principle is expressed by the ancient maxim:

"He who comes into equity must come with clean hands."

Litton's frauds and deceptions are deliberate and each one was a step in a general plan which can now be viewed as a whole. The fraudulent scheme relates directly to the subject matter of the present controversy.

The first rule of estoppel is that the one claiming the benefit of the estoppel must have been free from fraud in the transaction. Otherwise no equity will arise in his favor.

Pomeroy's Equity Jurisprudence, (3rd Ed.), sec. 513.

Litton's frauds and deceptions are proven by the record in this case. At the risk of being repetitious, we again point out the various steps in the fraudulent plan, which achieves its intended result if the judgment of the Circuit Court of Appeals is allowed to stand.

1. The three fictitious entities, a partnership and two corporations with the same name, employed by Litton to hinder, delay and defraud A. P. Pepper from collecting rents and royalties due under a lease. Pepper, the lessor, had no way of knowing of the existence of these three distinct companies until the cross bill filed by Litton in the initial proceeding in this litigation. See *Pepper* v. *Dixie Splint Coal Co.*, 165 Va. 179.

2. The judgment Litton attempted to have his sub-

servient office man confess against the bankrupt in favor of himself (Litton). On June 2, 1933, when the proof in Pepper's suit for an accounting was practically completed, Litton, in anticipation of the outcome of the suit, attempted a confession of judgment against the bankrupt and in favor of himself, in the amount of $33,468.89. This attempted confession of judgment was void, however, because of a non-compliance with the Virginia Statute (Code Section 6130A). The amount of this attempted confession of judgment, namely, $33,468.89, was made up in the main, of an unpaid "salary" item of $26,041.84, allegedly due Litton's subservient office man, P. H. Smith, which was assigned to Litton, in consideration of one dollar "and other valuable considerations." (R. 89). On cross examination (R. 88) *Litton could not recall or itemize a single item or "valuable consideration"* which he gave Smith in return for the assignment of a $26,041.84 claim against the Bankrupt;

3. The false explanation of Litton's reasons for obtaining the confessed judgment, on June 2, 1933, namely, that Pepper, by her attachments, executions, etc., was responsible therefore when Pepper's judgment was not obtained until February 19, 1934;

4. The fact that Litton, although he sued out executions on his void judgment, withheld levy thereunder from June 2, 1933, until March 19, 1934;

5. The false representations made by Litton to the Bristol court that he intended to apply for an appeal and supersedeas to the Pepper's $9,000.00 judgment, and upon which he stayed execution of Pepper's judgment from February 19, 1934, until May 19, 1934;

6. The suing out and levying of an execution from his purported judgment by Litton during the stay period on Pepper's judgment; and the advertisement of sale under

Litton's levy by the sheriff on the same day that Pepper's execution was placed in the sheriff's hands for levy;

7. The purchase by Litton at the execution sale of all the property of the bankrupt for $3200.00 on June 14, 1934, and the resale of the property to another Dixie Company organized by Litton for $20,135.36;

8. The delay in filing a voluntary petition in bankruptcy for the bankrupt from June 16, 1934, until September 7, 1934, or seventy-nine days, during which period Litton's levy lien became of more than four months' standing, and Pepper's levy lien was less than four months' standing;

9. The unexplained failure of Litton to give the address of Pepper, which was well known to him, in the schedules of the bankrupt, thus preventing Pepper from participating in the first meeting of creditors;

10. The election, at the first creditors' meeting, of P. H. Smith, Litton's subservient office man, as trustee in bankruptcy; and the selection by the trustee of Litton's and the bankrupt's counsel as attorney for the trustee;

11. The cancellation on June 16, 1934, of bankrupt's Clinchfield lease; and the action of Litton in obtaining a new lease from Clinchfield of the same premises to another "Dixie" Company on June 22, 1934, thus giving to Litton the same lease-hold premises and the same mining equipment, books and office furniture and supplies on June 22, 1934; and permitting him to continue business on the same premises with the same equipment that the bankrupt owned on the date of the sale, namely, June 14, 1934, and at a net cost of only $1,047.00 ($3200.00 less $2153 paid on an admitted debt).

12. The so-called "personal" ledger salary accounts

of Litton and Smith set up to evade federal income tax due from Dixie Splint Coal Company, and to be utilized as a shield against bona fide creditors in the event of financial difficulties of the corporation;

13. The absurd contention that Smith, the secretary-treasurer of the bankrupt, permitted his unpaid salary account to reach the total of $26,041.84 in five years;

14. The transfer of Smith's fictitious ledger balance to Litton for no consideration; the attempted confession of judgment on Litton's fictitious ledger balance, made up largely of the transfer from Smith at a time when Pepper was reducing her bona fide claim against Dixie Splint Coal Company to judgment;

15. The false testimony of Litton that the entire sum of $33,468.89 was made up of unpaid salary balances due to him alone;

16. The action of Litton in attempting to purchase or have withdrawn every claim against the bankrupt with the sole exception of Pepper's claim;

17. The action of Litton and Smith of withdrawing by means of their fictitious accounts of all the monies of Dixie Splint Coal Company on the eve of its planned bankruptcy.

We submit that the District Court was fully justified when it said:

> "It would be a strange situation if this Court, or any other, in a matter pending solely before it, were compelled to confess itself powerless to prevent the perpetration of such gross and obvious fraud as has been sought to be accomplished here." (R. 61).

In a similar case this Court held that it was not ren-

dered powerless by the doctrine of estoppel to prevent the consummation of a fraudulent scheme in the bankruptcy court.

Buffum v. *Peter Barceloux Co.*, 289 U. S. 227, 53 S. Ct. 539.

VI.

CONCLUSION

We submit that for the reasons assigned the decision of the United States Circuit Court of Appeals, Fourth Circuit, rendered January 9, 1939, is erroneous and should be reversed. For the same reasons the judgment of the District Court of the United States for the Western District of Virginia, rendered June 23, 1938, is plainly right and should be affirmed.

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